

Thus, current per household outlays can be a misleading indicator of the comparative costs of assisting an additional household through the various programs, and deriving cost comparisons is a complex task. Some major studies, employing different methodologies, have shown the Section 8 new construction and substantial rehabilitation program to be from 60 percent to 100 percent more expensive than the Section 8 existing-housing program.<sup>11</sup> Disagreement exists among these and other studies, however, regarding the relative costs of public housing. One study found that, regardless of what assumptions were used concerning future increases in housing expenses and tenants' incomes, public housing was from 30 percent to 50 percent more expensive than the Section 8 existing-housing program but always cheaper than Section 8 new construction.<sup>12</sup> On the other hand, another study, which employed extensive data on project characteristics as well as more comprehensive estimates of indirect subsidies, found that the cost of subsidizing the same unit occupied by the same household through public housing was generally more expensive than through the Section 8 new construction program.<sup>13</sup> The cost of public housing exceeded that of Section 8 new construction, ranging from a negligible amount to 44 percent, depending on the particular variant of the Section 8 program. (This study did not include cost comparisons with the Section 8 existing-housing program.)

Although updating these studies is beyond the scope of this paper, illustrative estimates of the long-term direct expenditures for subsidizing an elderly household under the three currently active major programs are presented in Table 9. Under some simplifying assumptions regarding future inflation rates and the length of time a unit will be in the assisted housing stock, expenditures for an elderly household

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11. See, for example, Congressional Budget Office, *The Long-Term Costs of Lower-Income Housing Assistance Programs* (March 1979). For a comparison of the costs of Section 8 existing-housing certificates and Section 8 new construction, see Abt Associates, Inc., *Participation and Benefits in the Urban Section 8 Program*, prepared for the Department of Housing and Urban Development (January 1981). For a detailed comparison of the costs of the various HUD production programs, see Urban Systems Research and Engineering, Inc., *The Costs of HUD Multifamily Housing Programs*, prepared for the Department of Housing and Urban Development (May 1982).
  12. See Congressional Budget Office, *The Long-Term Costs of Lower-Income Housing Assistance Programs*.
  13. See Urban Systems Research and Engineering, Inc., *The Costs of HUD Multifamily Housing Programs*.

TABLE 9. ILLUSTRATIVE ESTIMATES OF THE 20-YEAR COSTS OF  
SUBSIDIZING AN ELDERLY HOUSEHOLD THROUGH  
VARIOUS HOUSING PROGRAMS, 1988-2008

Program	20-Year Costs		Present Discounted Value Using Various Real Discount Rates <sup>a</sup>		
	Current Dollars	1988 Dollars	0.5 Percent	2 Percent	4 Percent
Section 8 Existing-Housing	112,300	68,900	65,400	56,400	47,000
Section 202/8 New Construction	80,700	71,300	70,400	67,700	64,600
Public Housing	89,700	76,800	75,800	73,200	70,400

SOURCE: Congressional Budget Office estimates.

NOTE: These estimates are based on simplifying assumptions and are meant to illustrate inherent cost differences rather than represent definitive projections of program costs. The following assumptions and data were used:

- o The Section 202/8 unit and the public housing unit are constructed in 1988 and become occupied in 1989. The Section 8 existing-housing unit also becomes occupied in 1989.
  - o A 20-year holding period is assumed for the two new construction programs, thereby eliminating the need to consider the cost of major rehabilitation in public housing after 15 to 20 years, which is not covered by operating expenditures. Thus, it is assumed that the 40-year Section 202 loan is paid off in full in the twentieth year. To the extent that units have a useful life after 20 years, even without rehabilitation expenditures, this simplified assumption makes public housing appear more expensive.
  - o Only direct expenditures are included. Expenditures for both components of the Section 8 program consist of the differential between the unit's rent and 30 percent of the tenant's adjusted income; for public housing, they consist of the up-front grant for the construction costs and an annual operating subsidy thereafter. This approach underestimates the federal costs of Section 202/8 because of favorable financing received by developers, and excludes the costs borne by state and local governments under both production programs because of forgone local property taxes.
  - o Over the 20-year period, tenants' income is assumed to rise at the same rate as rents in the Section 8 program and as operating costs in public housing. An average inflation rate of 4.5 percent is assumed for the current dollar estimates.
  - o Based on HUD estimates, the average construction cost in 1988 for a unit developed under Section 202/8 for an elderly household is assumed to be \$45,741. Under public housing a unit with similar characteristics is estimated to be 24 percent more expensive--based on findings of Urban Systems Research and Engineering, Inc., *The Costs of HUD Multifamily Housing Programs*, prepared for HUD (May 1982). In 1988, the estimated first-year rent subsidy for an elderly tenant with an average adjusted income of \$5,643 is \$3,765 under Section 8 existing-housing (including the administrative fee), and \$4,913 under Section 202/8. Similarly, the average operating subsidy under public housing is estimated at \$1,052.
- a. The real (inflation-adjusted) long-term discount rate depends on the differential between long-term federal borrowing costs and the rate of inflation. In the long run, this rate is estimated to be around 2 percent, but it could vary at least between near 0 and 4 percent. Present discounted values reflect conceptually the amount of money one would have to put in the bank today if interest were earned at the nominal--not inflation-adjusted--discount rate in order to cover the future stream of subsidies.

with a given income over a 20-year period--when measured in current dollars--appear lowest in the Section 202/8 program and highest in Section 8 existing-housing. When measured in constant 1988 dollars, however, Section 8 existing-housing is 10 percent cheaper than public housing and 3 percent cheaper than Section 202/8. When also controlling for the time value of money by considering the present discounted value of the stream of subsidy payments, the Section 8 existing-housing program becomes substantially cheaper than Section 202/8 and public housing, particularly as the real discount rate is raised.<sup>14</sup> These results occur because both the public housing and Section 202/8 programs require large up-front federal expenditures for construction, with relatively low net annual outlays for household subsidies thereafter. By contrast, under the Section 8 existing-housing program, annual payments are more consistent over time, with larger amounts therefore occurring far into the future where higher discount rates reduce the present value of those payments.

## THE DISTRIBUTION OF FEDERAL HOUSING AID

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Only a relatively small proportion of the population targeted by federal housing programs is currently served. The pool of assistance is unevenly distributed among different types of households and locations, reflecting both the varying rates at which different housing programs serve different types of households and the mix of outstanding commitments.

### Rental Assistance Programs

Although the largest share of all rental subsidies is received by the primary target population--that is, renters with income at 50 percent or less of the area's median income adjusted for family size--a lack of reliable data on the current distribution of aid across income groups makes it difficult to estimate the proportion of very-low- and

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14. The real (inflation-adjusted) long-term discount rate depends on the differential between long-term federal borrowing costs and the rate of inflation. Present discounted values reflect conceptually the amount of money one would have to put in the bank today if interest were earned at the nominal (not inflation-adjusted) discount rate in order to cover the future stream of subsidies.

low-income households that can be served with commitments for which funds have already been appropriated. In 1981, less than 15 percent of all rental assistance administered by HUD went to households with income above 50 percent of the area's median, ranging from about 7 percent for the Section 8 existing-housing program to over 30 percent for the Section 236 program.<sup>15</sup> Since that time, almost all new housing assistance has gone to very-low-income households, but data are not yet available to determine the effects of this legislation on the overall distribution of housing aid.<sup>16</sup>

Estimates of the proportion of eligible households served also vary depending on how the eligible population is defined. For example, under current law, households consisting of single persons or groups of unrelated individuals can receive assistance only under special conditions (see Box 2 in Chapter II). Thus, one might argue that such households should be excluded when determining the size of the eligible population. On the other hand, excluding all of them would understate the number who are eligible, since no one is excluded a priori from program participation and an unknown number of such households meet the special conditions.

Another issue concerns whether or not to include homeowners in the eligible population. Homeowners who sold their homes would be eligible for rental assistance if they met the income-eligibility criteria, but some who are currently classified as very-low- or low-income would not be income-eligible, because returns on the liquidated equity from their homes would be imputed and added to their annual income. Available data on the amount of equity now held in the form of owner-occupied housing, however, are not reliable enough to estimate the number of households that would no longer meet the income-eligibility criteria.

In view of these concerns, this study produced alternative estimates of the proportion of eligible households that could be served,

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15. See Paul Burke, "Trends in Subsidized Housing, 1974-1981" (unpublished paper, Department of Housing and Urban Development, March 1984).

16. Under current law, households classified as low-income may generally occupy, in the aggregate, no more than 25 percent of all units that were available for occupancy before 1981 and no more than 5 percent of units made available since that time. These limitations do not have to be achieved, however, in the individual assistance programs.

ranging from 12 percent to 49 percent (see Table 10). In particular, if all of the 4.65 million rental assistance commitments available from past appropriations were received exclusively by very-low-income

TABLE 10. ALTERNATIVE ESTIMATES OF THE PROPORTION OF THE ELIGIBLE POPULATION THAT COULD BE SERVED BY RENTAL ASSISTANCE PROGRAMS, 1988

Definition of Eligible Population	Estimated Number of Eligible Households (Thousands)	Percentage Served By	
		100 Percent of 4.65 Million Commitments	90 Percent of 4.65 Million Commitments <sup>a</sup>
Very-Low-Income Households			
Renters			
Including single persons	12,200	38	34
Excluding single persons	9,500	49	44
Renters and Homeowners <sup>b</sup>			
Including single persons	22,600	21	19
Excluding single persons	19,100	24	22
Very-Low- and Low-Income Households			
Renters			
Including single persons	18,600	25	n.a.
Excluding single persons	14,000	33	n.a.
Renters and Homeowners <sup>b</sup>			
Including single persons	37,700	12	n.a.
Excluding single persons	31,600	15	n.a.

SOURCE: Congressional Budget Office estimates.

NOTE: Estimates of the number of eligible households are based on 1985 American Housing Survey, adjusted for growth in the number of households between 1985 and 1988, assuming the number of very-low- and low-income renters grew at the same rate as the number of households in general. Income categories are defined in Box 2 in Chapter II. Excludes renters that pay no cash rent.

Single persons are defined here as including households of one person or groups of unrelated individuals.

n.a. = not applicable.

- a. Since 1981, housing assistance has been targeted almost exclusively toward very-low-income households. A small but unknown proportion of assisted units, however, are still occupied by low-income renters. These figures assume that 90 percent of commitments are received by very-low-income renters, with 10 percent going to low-income renters.
- b. Some of the homeowners classified here as very-low- or low-income would not be eligible for rental assistance if they sold their homes. Under current law, returns on any liquidated equity in their homes would be imputed and added to their annual income to determine whether the households met the income-eligibility requirements. Available data on the amount of equity now held in the form of owner-occupied housing, however, are not reliable enough to estimate the number of homeowners who would be ineligible for assistance. Thus, the number of potentially eligible homeowners is somewhat overstated here.

renters, up to 38 percent of the 12.2 million renters estimated to have very low incomes in 1988 could eventually be served. Assuming that about 10 percent of all assisted units will still be occupied by low-income families, however, about one-third of all very-low-income renters would actually receive assistance. Including renters classified as low-income in the eligible population reduces the proportion that could be served with available aid to one-fourth. Excluding single persons and groups of unrelated individuals would increase all these estimates by roughly a third, while including homeowners currently classified as very-low- or low-income would reduce them by about half.

Aid is unevenly distributed among various household groups in the target population (see Table 11). The roughly 2 million outstanding commitments available to the elderly can serve an estimated 51 percent to 57 percent of all very-low-income elderly renters, depending on how many of these commitments currently go to low-income elderly households. By contrast, commitments available to both large and small families with children can serve at most roughly 38 percent of those with very low incomes. Only 19 percent of all very-low-income nonelderly households with no children present can be served with the commitments available to them, although the proportion of this group eligible for aid is not known. Finally, the proportion of very-low-income renters in metropolitan areas that can be served appears substantially lower than that in nonmetropolitan areas. Reliable figures for these proportions are difficult to estimate, however, because the definition of metropolitan areas used in estimating assisted units differs from that used in estimating eligible households.

This uneven distribution is mainly the result of inherent differences in the rates at which programs serve various types of households, as well as the changing mix among programs over the past 12 years. New construction programs traditionally have helped elderly renters at rates exceeding their share of the very-low-income renter population, which is estimated to be about 29 percent in 1988 (see Table 12). This tendency is particularly strong in the Section 8 new construction program, under which more than two-thirds of all subsidies are received by the elderly, but is less pronounced in the older production programs such as public housing and Section 236. Moreover, while programs that assist renters living in existing dwellings are more likely than the production programs to serve families with children, they too aid the elderly disproportionately. Thus, from 1977

to 1980, when the Section 8 new construction program was very active, around half of all new commitments were for the elderly (see Figure 6). Since then, the emphasis has shifted toward existing-

TABLE 11. ESTIMATED DISTRIBUTION OF THE ELIGIBLE POPULATION AND THE RENTAL ASSISTANCE AVAILABLE FOR VARIOUS GROUPS OF HOUSEHOLDS, 1988

Type of Household	Very-Low-Income Renters (Thousands) <sup>a</sup>	Assisted Units Available to Group (Thousands) <sup>b</sup>	Percentage Served By	
			All Commitments Available to Group	90 Percent of Commitments Available to Group <sup>c</sup>
Elderly, No Children	3,500	1,990	57	51
Nonelderly, No Children	3,500	660	19	17
Households with 1 or 2 Children	3,600	1,380	38	35
Households with 3 or More Children	1,600	620	38	34
In Metropolitan Areas	10,000	3,110 <sup>d</sup>	d	d
In Nonmetropolitan Areas	2,200	1,540 <sup>d</sup>	d	d
Total	12,200	4,650	38	34

SOURCE: Congressional Budget Office estimates based on information provided by the Department of Housing and Urban Development and the Farmers Home Administration.

NOTE: Income category and household types are defined in Box 2 in Chapter II.

- a. Estimates of the total number of very-low-income renters are based on the 1985 American Housing Survey, adjusted for growth in the number of households between 1985 and 1988, assuming the number of very-low- and low-income renters grew at the same rate as the number of households in general. Excludes renters that pay no cash rent.
- b. Includes units still being processed at the end of fiscal year 1988.
- c. Since 1981, housing assistance has been targeted almost exclusively toward very-low-income households. A small but unknown proportion of assisted units, however, are still occupied by low-income renters. These figures assume that 90 percent of commitments are received by very-low-income renters, with 10 percent going to low-income renters.
- d. Based on HUD's 1981 estimate that 28.5 percent of its aid goes to nonmetropolitan areas and the General Accounting Office's 1980 estimate that 83.4 percent of FmHA rental assistance goes to nonmetropolitan areas. The definition of metropolitan areas has changed since these estimates were made, however, with many nonmetropolitan areas being reclassified as metropolitan areas. Thus, the number of assisted units is likely understated for metropolitan areas as defined by the 1985 American Housing Survey and overstated for nonmetropolitan areas. Therefore, the percentage of eligible households served cannot be calculated.

**TABLE 12. DISTRIBUTION OF THE ELIGIBLE POPULATION AND OF RENTAL AID UNDER VARIOUS PROGRAMS, 1988**  
(In percents)

	Type of Household				All
	Elderly, No Children	Nonelderly, No Children	With 1 or 2 Children	With 3 or More Children	
As a Percentage of Very-Low-Income Renters					
Eligible Population in 1988	29	29	29	13	100
Percentage of Total Aid Received by Type of Household					
Section 8 Existing- Housing/Vouchers <sup>a</sup>	32	15	38	15	100
Section 8 New Construction and Substantial Rehabilitation	68	10	17	5	100
Public Housing	38	15	29	19	100
Other HUD Programs <sup>b</sup>	41	19	30	10	100
Section 515 Rural Rental Assistance	51	16	25	9	100
Total	43	14	30	13	100

**SOURCE:** Congressional Budget Office estimates based on data provided by the Department of Housing and Urban Development and the Farmers Home Administration.

**NOTE:** Income category and household types are defined in Box 2 in Chapter II.

Federal statistics on housing aid to the elderly commonly include commitments to households headed by handicapped individuals. In this table, however, figures for the elderly include the share of aid that goes to the handicapped elderly, while aid to other handicapped households is reflected primarily in the category of nonelderly households without children present. Overall, the handicapped occupy an estimated 8 percent of public housing units and 12 percent of Section 8 new construction units.

a. Includes Section 8 moderate rehabilitation, loan management, property disposition, and conversion assistance.

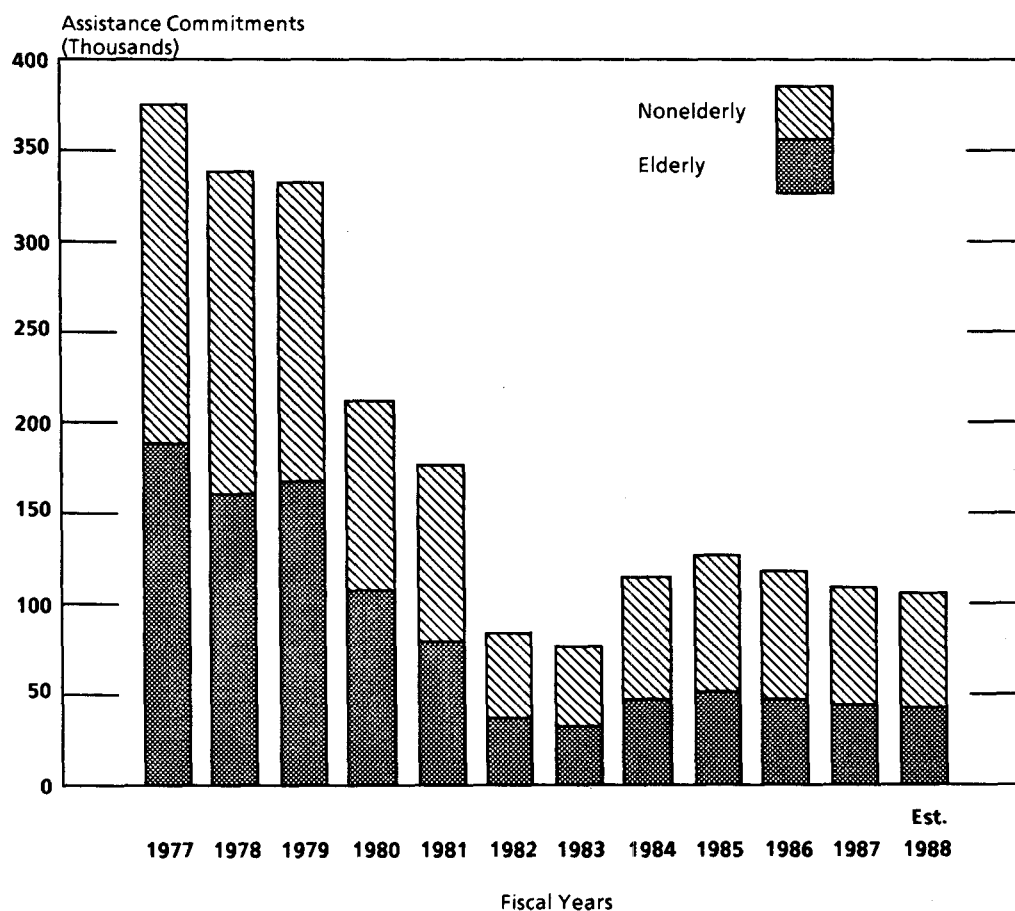
b. Includes Section 236 and rent supplement programs.



housing programs, and the share of annual commitments going to the elderly has declined to around 40 percent, but the elderly are still receiving an estimated 43 percent of all rental aid.

The uneven locational distribution of aid is explained mostly by the rates at which the administering agencies allocate assistance. According to 1981 data, an estimated 71 percent of all aid provided

Figure 6.  
Net New Rental Commitments for Elderly  
and Nonelderly Households, 1977-1988



SOURCE: Congressional Budget Office based on data provided by the Department of Housing and Urban Development and the Farmers Home Administration.

through HUD programs goes to metropolitan areas.<sup>17</sup> All aid provided through FmHA must go to rural areas, but available data from a 1980 study suggest that around 17 percent of its rental assistance goes to rural portions of metropolitan areas.<sup>18</sup> On the whole, metropolitan areas as defined in these studies would receive around two-thirds of all aid, but using a more current definition would likely show a somewhat larger share. Metropolitan areas as defined by the 1985 American Housing Survey, however, contain more than four-fifths of the target population.

### Homeownership Programs

Homeownership programs probably serve groups with higher incomes than do rental assistance programs, because the size of the subsidy may not reduce out-of-pocket expenditures sufficiently to make homeownership affordable for very poor households.<sup>19</sup> Furthermore, compared with rental assistance programs, the requirements for targeting the very-low-income population are much less stringent under Section 502 and are nonexistent under Section 235. Reliable data are not available, however, on the distribution of homeownership assistance among various income categories of the eligible population.

Over the past decade, homeownership assistance has been provided each year to a small proportion of homebuyers whose income is up to 95 percent of the area's median. On average, federally subsidized mortgages have aided about one in ten of these lower- and moderate-income homebuyers in any year, with the proportion probably declining recently because of cutbacks in the number of annual commitments provided. Although little information exists on the distribution of aid among demographic groups, elderly homebuyers typically have received an estimated 3 percent of FmHA's Section 502

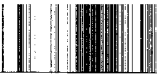
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17. Burke, "Trends in Subsidized Housing."

18. General Accounting Office, *Ways of Providing a Fairer Share of Federal Housing Support to Rural Areas* (March 28, 1980).

19. Both the Section 502 and the Section 235 programs put floors on household expenditures by specifying a minimum interest rate that the owner must pay, currently as low as 1 percent for the Section 502 program. Legislative requirements to target FmHA funds toward the poorest households have, for example, resulted in portions of funds earmarked for very-low-income households not being spent in a timely fashion because few such households that applied qualified for a mortgage. See General Accounting Office, *Rural Housing: Opportunities to Reduce Costs and Better Target Assistance* (February 1986).

mortgages and an estimated 16 percent of the Section 235 commitments. By comparison, in 1985, around 19 percent of all homeowners with income below 80 percent of the area's median who had purchased their homes during the previous year were elderly.



## **CHAPTER IV**

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### **OPTIONS FOR DETERMINING THE TYPES OF AID TO PROVIDE**

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Because housing assistance is not an entitlement program and because it can be provided through many different approaches, a number of recurring questions must be resolved each year concerning the funding of housing aid. These questions include:

- o What types of assistance should be provided and how should they be financed?
- o Which types of households should have priority for receiving assistance?
- o How large a subsidy should households receive?
- o How many households should receive housing assistance?

Resolving these four issues involves a trade-off among annual program costs, the number of eligible households served, and the average subsidy provided per assisted household. Total program costs are affected both by the number of households served and by the average subsidy per household, which in turn depends on decisions regarding the program mix, the types of households served, and the out-of-pocket expenditures made by assisted households. For example, targeting more subsidies toward households that are on average more expensive to assist, such as very poor or very large families, would raise program costs. These added expenses could be offset wholly or in part by decreasing program coverage, by decreasing the size of each recipient's subsidy, by shifting the current program mix toward less expensive forms of assistance, or by a combination of these mechanisms.

Traditionally, these questions have been dealt with at the federal level, although localities have had some discretion regarding the program mix. More or all control over these decisions, however, could be transferred to state and local governments, who presumably are in a better position than the federal government to know their local

housing needs and may be better able to develop cost-effective strategies to address those needs.<sup>1</sup> On the other hand, potential divergences between local and national policy goals would argue in favor of retaining control at the federal level.

A related issue of growing importance will also affect decisions on how to deal with some of these questions, be it at the federal, state, or local level. This issue concerns the potential loss of housing assistance commitments resulting from the impending expirations of many multiyear subsidy contracts, and of opportunities for certain private owners of federally assisted projects to opt out of their obligations to make their units available to lower-income tenants at controlled rents. Thus, decisions must be made not only about the amount and nature of any additional assistance, but also whether and how to respond to this reduction in commitments. These choices involve many of the same trade-offs as those for providing additional assistance. In fact, although specific approaches for keeping units in the programs are not discussed in this paper, many of the policy options presented here might be considered in future deliberations on how to fund either additional or continued assistance.<sup>2</sup>

The remainder of this chapter deals with the first question--what types of assistance to provide. Questions concerning the targeting of assistance, the size of the subsidy, and the number of households to serve are considered in Chapter V.

## BROAD CONCERNS REGARDING PROGRAM MIX

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Deciding what types of assistance to provide depends largely on the particular policy goals being pursued and the groups being targeted for assistance. Traditional policy goals have included improving the

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1. One way of shifting control would be to provide some or all housing assistance through block grants. See Appendix B for a brief discussion of the debates on this approach.
  2. For a more detailed discussion of this issue and an overview of options for dealing with the potential loss of units from the assisted inventory as owners opt out of the programs, see Congressional Budget Office, "The Potential Loss of Assisted Housing Units as Certain Mortgage-Interest Subsidy Programs Mature" (Staff Working Paper, March 1987); and National Low-Income Housing Preservation Commission, *Preventing the Disappearance of Low-Income Housing* (Washington, D.C.: National Corporation for Housing Partnerships, 1988).

quality of housing, thereby ensuring minimum housing standards; limiting the proportion of income spent for housing, thereby freeing a household's income for consuming other goods; increasing locational opportunities for lower-income households; increasing homeownership opportunities; stimulating residential construction and rehabilitation for lower-income households; and promoting stabilization, revitalization, and the economic and racial integration of neighborhoods. Major lower-income groups being assisted include the elderly, the handicapped, and families with children.

The ultimate choice regarding the program mix for which to appropriate funds, if any, would depend on the relative priorities among these policy goals in a given year. For example, a desire to increase homeownership opportunities for lower-income households--most of whom would be families with children--could be met by shifting from the current focus on rental assistance. Alternatively, emphasis on resolving the problem of high housing costs relative to income could be achieved by increasing funding for programs such as Section 8 existing-housing and vouchers, approaches that could target any group within the eligible population. Increasing the number of affordable and physically adequate units for lower-income households could be accomplished by devoting more funds to new construction or rehabilitation programs. Depending on the types of units constructed, aid could be targeted toward the elderly, for example, or to large families. Some of these policy goals could also be addressed by providing households with unrestricted cash grants rather than with aid tied to housing.<sup>3</sup>

Another factor to be considered is that the program mix affects both total budget authority requirements and the pattern of annual outlays over time, because programs vary in their per unit subsidy costs and their financing mechanisms. For example, as previously noted, new construction programs generally require larger amounts of budget authority than existing-housing programs, both because rents of newly constructed units are typically higher and because commit-

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3. In this study, providing cash grants is regarded as an alternative to housing assistance rather than as a type of assistance. It is therefore not further discussed in this chapter but appears in Chapter V as an option for aiding poor households if housing assistance were phased out. For a detailed analysis comparing the effectiveness of cash grants and housing vouchers in meeting various policy goals, see Ira S. Lowry, ed., *Experimenting with Housing Allowances* (Cambridge, Mass.: Oelgeschlager, Gunn and Hain, 1983).

ments for them are usually for a longer period of time than are those for units in the existing-housing stock.<sup>4</sup> In addition, new construction programs often require large up-front outlays, if--as is the case for all currently active new construction programs--the government provides all or part of the construction financing through grants or direct loans.

The remainder of this chapter considers the mix between assistance to homeowners and renters, and, within each type of aid, the particular programs that might be funded.

#### THE MIX OF RENTAL ASSISTANCE VERSUS HOMEOWNERSHIP ASSISTANCE

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Over the past 12 years, the number of new commitments made available each year to assist lower- and moderate-income homebuyers has been small relative to that provided to aid renters, and it has been decreasing during the 1980s. For 1989, funds were appropriated to provide direct loans to an estimated 27,000 homebuyers through the FmHA Section 502 program. The Congress could increase, leave unchanged, or decrease the emphasis on aid to homebuyers; or it could terminate this form of assistance, as proposed by the Administration in recent budget submissions.

Assistance to homebuyers provides lower-income households with opportunities to gain financial equity in an asset and thus to accumulate some wealth. In the absence of changes in the current tax code--which encourages homeownership for middle- and upper-income households, many of whom would likely choose to own rather than rent even without added incentives--supporters of homeownership assistance argue that it should be available to households whose incomes are too low to benefit in any substantial way from tax expenditures. Furthermore, homeownership is thought to confer social benefits in the form of better maintenance of lower-income properties, promotion of family and neighborhood stability, and greater participation in community affairs. In addition, if aid were targeted

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4. The first fact is real--it does increase the cost to the federal government--but the second is an accounting artifact in that existing-housing commitments are commonly expected to be renewed when their terms expire.



toward better-off households currently living in assisted rental projects, their units would be available to help poorer households that are on waiting lists for subsidized housing.

Homeownership aid might be more effective than rental aid for certain types of households. For example, families that need large units (those with three or more bedrooms) may be more likely to find them in the owner-occupied stock, which contains 84 percent of all such units and 70 percent of all large units occupied by lower-income households. Furthermore, single-family homes may provide a more suitable living environment for families with three or more children; of the large units occupied by lower-income renters, however, only 60 percent are in single-family homes compared with well over 90 percent of large units occupied by lower-income owners. Homeownership assistance also may still be needed in those rural areas where mortgage-lending institutions are scarce and the supply of rental housing is limited, particularly in areas that lack the population density or the infrastructure to support rental developments.

By contrast, proponents of decreasing or even eliminating homeownership assistance argue that scarce federal resources should be targeted toward the poorest households. Most beneficiaries of current subsidized homeownership programs are low- and moderate-income households, since the mortgage-interest subsidies tend to be insufficient to enable the poorest segment of the population to purchase homes. Furthermore, because rental assistance is not an entitlement and only a fraction of eligible households are now served, many homeowners who receive subsidies have higher incomes and better living quarters than many families who are not assisted.

Another argument against assisting homeowners is that poor households may benefit more from rental assistance programs. Lower-income households may have difficulties managing homeownership when they encounter unexpected repair bills or when they experience loss of income--because of unemployment spells, for example. Many such households are likely to default on their mortgages and to be subjected to foreclosure--as evidenced, for example, by past high foreclosure rates in the Section 235 program. Thus, they are relatively vulnerable to losing their home and any accumulated equity.

## TYPES OF ASSISTANCE TO HOMEOWNERS

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Several basic approaches are available for providing direct assistance to lower-income homeowners. The traditional method has been to reduce mortgage payments for homebuyers through mortgage-interest subsidies. Another approach would be to reduce the principal amount of the mortgage--for example, by providing grants for down-payments, by extending interest-free second mortgages that become due at the time of resale, or by otherwise reducing the purchase price. A third approach would be to offer subsidies to homeowners through vouchers similar to those available to renters.<sup>5</sup>

### Mortgage-Interest Subsidies

Opportunities for poor rural households to own a home could be expanded by continuing to provide additional commitments through the FmHA Section 502 program--the only currently active program of this sort. For 1989, the average lending authority per mortgage is estimated to be about \$47,000. Because this program provides direct loans to homebuyers, it requires large up-front federal outlays, which are partially offset over time by a stream of income to the government as the household repays the mortgage over a certain period--generally up to 33 years. In addition, if the home is sold, the government recaptures all or a portion of the nominal value of the accrued subsidies, with the amount depending on the owner's equity and any capital gains. Thus, the ultimate cost to the federal government is the difference between the government's borrowing cost and the interest paid by the homebuyer, plus any costs incurred if borrowers default on their loans, minus any costs recaptured at time of sale.<sup>6</sup>

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5. Homeownership assistance to lower-income households could also be provided by changing the tax code to allow tax credits rather than deductions for mortgage interest and property taxes.
  6. The 1986 Budget Reconciliation Act authorized the sale of FmHA mortgage instruments to the public. Such sales could offset the up-front outlays immediately, except for the discount that the government must absorb to provide private investors with a market return and to compensate them for the risks of default and prepayment. Most sales, however, would probably involve older mortgages, whose default risk is relatively low. For new mortgages, the federal government would probably have to wait a few years before outlays could be offset by revenues from sales. A total of 141,000 Section 502 loans were sold during fiscal year 1987, with the government absorbing a \$1 billion loss.